

D. LOW-INCOME HOUSING AS A CHARITABLE ACTIVITY

by
Robert Louthian and Marvin Friedlander

**"There are three kinds of lies:
lies, damn lies and statistics."**

Benjamin Disraeli

1. Introduction

The 1988 median family income level in the United States was \$32,191. (The 1991 Information Please Almanac.) However, median income varies widely between geographic areas from over \$71,000 in Norwalk, Connecticut; to over \$57,000 in parts of California, Illinois, and Washington, D.C.; and under \$26,000 in parts of Texas and Colorado. (Compiled by the Department of Housing and Urban Development.) Despite these levels, thirteen percent of Americans had incomes below the poverty level, and you were designated at the poverty level if your income ranged from \$6,024 for a single person to \$12,092 for a four-person family. (The World Almanac and Book of Facts 1991.)

Providing housing assistance to persons at or below the poverty level would generally present a clear situation for promoting charity by offering relief to those who could not otherwise afford decent housing. However, in the cutting edge of organizations seeking to qualify under IRC 501(c)(3), we are encountering "low-income" or "affordable" housing programs geared toward persons whose incomes are near or slightly below the median income level or whose occupants represent a mix of very-low, low and moderate income families. Readers may be surprised to learn that there are low-income or affordable housing programs for which they may qualify. Affordable housing may be laudable. However, what makes low-income housing programs charitable is the amelioration of conditions for the poor and distressed or underprivileged.

This article will explore exemption under IRC 501(c)(3) for organizations that seek to relieve the poor and distressed through the provision of housing. It will seek to answer the following questions. What rules has the Service enunciated for housing assistance programs to be considered charitable? Who meets the definition of "poor and distressed" or "underprivileged"? Is it charitable for an organization to serve the housing needs of a mix of persons, only some of whom are poor and distressed or underprivileged?

2. The Basics

IRC 501(c)(3) provides for the exemption from federal income tax of those organizations that are organized and operated exclusively for charitable purposes.

Reg. 1.501(c)(3)-1(d)(2) provides that the term "charitable" is used in IRC 501(c)(3) in its generally accepted legal sense. Such term includes relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions; to eliminate prejudice and discrimination; or to combat community deterioration.

Homes for aged that provide special residential facilities and continuous health care for aged persons at the lowest feasible cost and maintain in residence those who become unable to pay the regular charges may qualify under IRC 501(c)(3) provided they otherwise satisfy the exemption requirements. See Rev. Ruls. 72-124, 1972-1 C.B. 145; 64-231, 1964-2 C.B. 139; and 61-72, 1961-1 C.B. 188.

Homes for the physically handicapped that provide specially designed housing at the lowest feasible cost and maintain in residence those tenants who subsequently become unable to pay the monthly fees may qualify under IRC 501(c)(3) provided they otherwise satisfy the exemption requirements. See Rev. Rul. 79-19, 1979-1 C.B. 195.

Rev. Rul. 70-585, 1970-2 C.B. 115, holds that nonprofit housing organizations created to aid low and moderate-income families by lessening neighborhood tensions, eliminating prejudice and discrimination, and combatting community deterioration may qualify for exemption under IRC 501(c)(3). The revenue ruling discusses four different situations involving organizations which provide low-income housing as their charitable purpose.

Situation 1 describes an organization which was formed to develop a program for new home construction and the renovation of existing homes for sale to low-income families on long-term, low payment plans. The organization purchases and renovates existing homes as well as builds new homes for sale to low-income families who qualify for loans under a federal housing program. The ruling holds that by providing homes for low-income families who could not otherwise afford them, the organization is relieving the poor and distressed; therefore, it is organized and operated exclusively for charitable purposes.

Situation 2 describes an organization formed to eliminate prejudice and discrimination. The organization constructs new housing for sale to minority groups with low and moderate-income levels who are unable to obtain adequate housing because of local discrimination. The housing units are located to help reduce racial and ethnic imbalances in the community and are sold at or below cost, or rented with an option to purchase, to minority families who cannot presently afford to purchase a home. The ruling holds that the organization's activities are designed to eliminate prejudice and discrimination and to lessen neighborhood tensions within the meaning of IRC 501(c)(3) and should be recognized as exempt under that section.

Situation 3 involves an organization formed to formulate plans for the renewal and rehabilitation of a particular area in a city as a residential community. Studies of the area showed that the median income in the area is lower than that in other sections of the city and the housing located in the area is generally old and badly deteriorated. The organization coordinated its efforts with the local redevelopment authority and developed an overall plan for the rehabilitation of the area. As part of the renewal project, it purchased an apartment house that it plans to rehabilitate and rent at cost to low and moderate-income families. The ruling holds that since the organization's purposes and activities combat community deterioration by assisting in the rehabilitation of an old and run-down residential area, they are charitable within the meaning of IRC 501(c)(3).

Situation 4 of the revenue ruling discusses an organization formed to provide moderate-income families with housing in a particular community. The organization in the situation was formed to build new housing facilities for the purpose of helping families to secure decent, safe, and sanitary housing at prices they can afford. The organization plans to erect housing that is to be rented at cost to moderate-income families. The organization is financed by mortgage money obtained under federal and state programs and by contributions from the general public. The situation concludes that since the organization's program is not designed to provide relief to the poor or to carry out any other charitable purpose within the meaning of the regulations, it is not entitled to exemption under IRC 501(c)(3).

In sum, Sit. 1 provides that making housing available to low-income persons who would otherwise be unable to afford housing is a charitable activity. Sit. 4 holds that providing housing to moderate-income persons is not a charitable activity. Sit. 2 and 3 hold that providing housing designed to eliminate prejudice

and discrimination and to lessen neighborhood tensions or to combat community deterioration is a charitable activity.

Unfortunately, these four situations don't define "poverty" for purposes of qualification for exemption. Also unanswered is whether the provision of housing to a mix of low, moderate and above-moderate income persons qualifies as charitable.

3. Relief of the Poor

In Situation 1 of Rev. Rul. 70-585, the organization's housing program was found to relieve the poor and distressed by providing homes for families who had low incomes and who could not otherwise afford the houses. Therefore, it operated exclusively for charitable purposes. Nowhere in the revenue ruling, however, is the term "low-income" defined. The revenue ruling states that the determination of what constitutes low income is a factual determination based on all the surrounding circumstances.

The terms "low-income" and "moderate-income" are defined in various legislative and administrative provisions in different ways so as to accomplish various goals. In the Internal Revenue Code, the closest definition of "low-income" is in IRC 42 concerning low-income housing tax credits. According to IRC 42(g), to be considered a "qualified low-income housing project," the housing project must set aside a certain number of units for low-income tenants. The project must set aside either 20% of the units for tenants who earn 50% of the area's median income (the "20-50 test") or 40% of the units for those who earn 60% of the area's median income (the "40-60 test"). In general, tax credits under IRC 42 are limited in their amount to that portion of the qualified low-income housing project which is set aside for those units occupied by qualifying tenants (those earning either 50% of the area's median income or 60% of the median income depending upon the test elected to be used.) Thus, for purposes of IRC 42, it appears that "low-income" refers to those tenants who earn 60% of the area's median income, or less, adjusted for family size.

The definition of "low-income" most commonly cited by housing organizations finds its genesis in the U.S. Housing Act of 1937, as amended (the Act). The Act, which is enforced and implemented by the Department of Housing and Urban Development (HUD), defines "low-income families" as families whose incomes do not exceed 80 percent of the median family income for the area, as adjusted for family size. The Act defines "very low-income families" as families

whose incomes do not exceed 50 percent of the median family income for the area, once again, as adjusted for family size. The major active, low income, HUD-assisted housing programs are the Public Housing program and the Section 8 certificate and voucher program. There is also an elderly/handicapped Section 202 program.

HUD's Public Housing and Section 8 programs require, in general, that for buildings placed into service after 1981 all of the available dwelling units must be occupied by "very low-income families" (those earning 50% of the area's median income) unless an exception is granted. Generally, exceptions are limited for any project to a maximum of 25% occupancy by persons at the low income levels. The Act's purpose in permitting a broad economic cross-section of families can be explained by the following reference to Senate Report No. 93-693, U.S. Congressional and Administrative News, 4311 (1974), which discusses the Housing and Community Development Act of 1974, Public Law 93-383:

While it is expected that public housing assistance will continue to give particular attention and priority to very low income families, the Committee expects that in the long run we would have more housing developments which are not occupied solely by the very poor, but by a cross-section of lower income households, representing a variety of household types. Experience has demonstrated that a cross-section of occupancy is an essential ingredient in creating economically viable housing as well as a healthy environment. It is recognized by this Committee that existing public housing in many of our largest cities has become a concentration of very poor families and often predominantly of families receiving public assistance. The provisions of this Act make it possible to develop new public housing with a cross-section of low income families.

Under the HUD Section 8 program, very low income families pay rent fixed at 30 percent of their income and the government pays the rest. HUD also publishes a fair market rent level to determine the maximum appropriate payment for housing in a particular area.

In G.C.M. 36293, (May 30, 1975), Chief Counsel stated that the fact that a purpose of an organization is to aid low and moderate-income families that qualify under a state mortgage loan program is not sufficient to qualify the organization as exempt under IRC 501(c)(3). In discussing HUD's guidelines, G.C.M. 36293 adds that there is no logical basis for treating a mere observance of the various restrictive provisions of HUD's programs as an adequate basis for according a charitable status to any and all housing organizations which comply with such provisions.

Regarding the application of HUD's standards to exempt organization determinations, we find an apparent conflict between G.C.M. 36293 and Rev. Rul. 76-408, 1976-2 C.B. 145. G.C.M. 36293 argues that aid to low and moderate-income families that qualify under a state mortgage loan program is not sufficient to qualify an organization as exempt under IRC 501(c)(3). Rev. Rul. 76-408, however, states that providing loans to persons who qualify as "low-income" under standards determined by an appropriate governmental agency is charitable because such activities are designed to relieve the poor and distressed. A closer analysis of Rev. Rul. 76-408, which reflects published Service precedent, indicates that the organization in the revenue ruling, like the organization described in Rev. Rul. 70-585, Sit. 1, must make a determination that persons qualifying for its assistance are at low income levels and can't otherwise afford to maintain their homes. The organization described in Rev. Rul. 76-408 is also engaged in activities which combat community deterioration. Thus, there is no actual conflict between the revenue ruling and G.C.M.; instead the revenue ruling merely presents more facts upon which it bases its favorable conclusion.

In Rev. Rul. 76-408, an organization makes loans to persons located in a badly deteriorated area where the median income level within the area is lower than in other sections of the city. The loans are made to homeowners, who could otherwise not qualify for such loans, to be used to bring the condition of their dwelling units up to the local housing code regulations. Before a loan is made to potential recipients, the organization requires recipients to demonstrate that they meet the "low-income" standards of a governmental agency and show that they are unable to obtain a loan elsewhere. From this, one can conclude that if the housing code violations were not corrected, massive displacements could occur which would contribute to the deterioration of the community. More importantly for purposes of this discussion, providing home repair loans based solely on meeting a governmental agency's low income standard was not, by itself, sufficient to qualify as a charitable activity without a further showing of actual distress caused by poverty that would impact on the ability of loan recipients to retain adequate housing.

The fact that an organization is providing housing to persons earning a particular percentage of the area's median income is generally not controlling in the determination of whether or not an organization is engaged in an exempt activity. The focus should be on whether the activities undertaken by an organization benefit a charitable class or otherwise promote social welfare within the meaning of Reg. 1.501(c)(3)-1(d)(2). Thus, families whose incomes are at 80% of the area's

median income, as adjusted for family size, do not necessarily constitute a charitable class and, therefore, housing assistance provided to such persons would not necessarily promote charitable purposes. They would not have demonstrably been shown as requiring assistance in securing or maintaining housing as a result of their financial condition.

4. The Standard

Chief Counsel, in G.C.M. 36293, discussed the basic issue of whether a corporation designed to provide low and moderate-income housing on a nondiscriminatory basis in a predominantly white, noncontiguous suburb of a large metropolitan area qualifies for exemption under IRC 501(c)(3). The organization (hereinafter "Corporation") involved was organized to provide and assist low and middle-income families in obtaining decent, moderately-priced housing in a suburban area of a major U.S city. The purpose of the Corporation encompassed not only the provision of such housing on a nondiscriminatory basis but also the education of the public about the need for such housing as well as the education of the public on the long-range financial, ecological, and sociological effects of providing such housing. The primary activity of the Corporation was the projected construction of a multi-unit housing project.

G.C.M. 36293 concluded that the Corporation does not fall within that aspect of charity which is concerned with providing relief to the poor or distressed or the underprivileged, because too few of its units were to be rented to low-income families. The fact that the purpose of the Corporation was to aid low and moderate-income families that qualified under a mortgage loan program was not sufficient to qualify the Corporation as exempt under IRC 501(c)(3), because the mere providing of homes for a group of such families is not recognized as a charitable purpose under IRC 501(c)(3).

Facts underlying the GCM reveal the following information. The building to be constructed by the Corporation was to have 60 units. The overall plan for the project contemplated that 15 of the 60 dwelling units would be rented to low-income persons and families who were to be selected under the general supervision of the local housing authority (LHA). In addition, another 20 to 30 units would be made available to tenants of moderate income levels at below-market rate rentals. The remaining units were to be rented to other persons or families at rentals sufficiently high to achieve and maintain a fiscally sound project. The LHA was to determine eligibility for the 15 low-income units pursuant to a schedule of priorities provided for under a state statute. This statute specifically authorized the

provision of such assistance to families of low-income who are therein characterized as being unable to afford decent, safe, and sanitary housing at prevailing rental rates without depriving themselves of the other necessities of life.

The memorandum provides that it is possible for a program of supplying housing assistance to low-income persons to qualify as a charitable activity because of serving to relieve poverty. It further states that it should be understood that the use of such an approach clearly requires the recipients of financial or other forms of assistance to be needy in the sense of being "unable to obtain the necessities of life without undue hardship." Hence, we have some guidance as to what constitutes the "poor" for purposes of making a factual determination based on all the circumstances - those lacking the basic necessities of life. By reference, this standard is derived from the law of charity as set forth in Scott on Trusts, Vol. IV, sec. 369.3 (1956).

Admittedly, this facts and circumstances standard is difficult to apply. Clearly, persons at or below the poverty level could be safely assumed to be lacking in sufficient financial resources to be able to afford housing without assistance. But, organizations that have no claim to exemption other than relief of the poor and distressed, must demonstrate that their housing program assists persons who, because of their impoverished circumstances, are unable to afford decent housing without foregoing the necessities of life.

5. Mixed Programs

Now that we have some guidance as to what constitutes relief of the poor, we are faced with another problem. Assuming that the organization providing the low-income housing bases its exemption on relieving the poor, what percentage of the organization's available dwelling units must be designated for use by the "poor"?

In general, organizations which are providing housing to low-income recipients will often reserve a certain percentage of units for sale or rent to moderate-income residents. In Sit. 4 of Rev. Rul. 70-585, the Service stated that the provision of housing to moderate-income families is not a charitable purpose. In G.C.M. 36293, Chief Counsel stated that reserving only 25% of the available units for low-income residents (those who are proper objects of charity) does not fall within that aspect of charity which is concerned with providing relief to the poor and distressed or the underprivileged because too few of the units were made available to low-income persons. As to what percentage of units must be

designated for use by the poor, G.C.M. 36293 is silent, (except, of course, to the extent it implies that the member must, at a minimum, be greater than 25%).

G.C.M. 36293 acknowledges that it has come to be general common knowledge that a limitation of the occupants of new subsidized housing developments to low-income families is likely to preclude such projects from providing satisfactory long-term alleviation of community deterioration commonly associated with deficient and overcrowded housing under congested city conditions. Thus, it would appear that the presence of some moderate-income persons in a low-income housing project would not defeat exemption. Although this statement appears in G.C.M. 36293 in the midst of a discussion on organizations designed to combat community deterioration, it appears relevant to organizations designed to relieve the poor.

There may be conditions under which a housing project that otherwise provides priority to the poor and distressed could accept some moderate-income families as being necessary to the furtherance of its charitable purposes by providing some degree of stability, resource and role model function, and prestige.

The percentage of housing that could be provided to persons who are not poor and distressed or underprivileged is a function of whether an organization is operated for a substantial nonexempt purpose, including furthering private interests more than incidentally.

IRC 501(c)(3) requires that an organization must be operated exclusively for exempt purposes.

In this respect, Reg. 1.501(c)(3)-1(c)(1) states that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in IRC 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. Moreover, Reg. 1.501(c)(3)-1(d)(1)(ii) states that an organization is not operated exclusively for exempt purposes unless it serves a public rather than a private interest.

Thus, if only an insubstantial part of an organization's activities is directed to a nonexempt purpose, it will not be disqualified from exemption. World Family Corp. v. Commissioner, 81 T.C. 958, 963 (1983). But, the existence of a single noneducational purpose, if substantial in nature, will destroy the exemption

regardless of the number or importance of truly educational purposes. Better Business Bureau v. United States, 326 U.S. 279, 283 (1945). Conversely, an organization engaging in nonexempt activities can keep its exempt status as long as such activities are only incidental and less than substantial. Church in Boston v. Commissioner, 71 T.C. 102, 107 (1978). As noted by the Tax Court in International Postgraduate Medical Foundation v. Commissioner, T.C.M. 1989-36, the less than substantial standard is a question of fact to be decided by reference to all relevant facts and circumstances.

In Columbia Park & Recreational Association, Inc. v. Commissioner, 88 T.C. 1 (1987), aff'd 838 F.2d 465 (4th Cir. 1988), an association that was created by the developers of a planned community for the purpose of operating recreational facilities for the homeowners of that community did not qualify for recognition of exemption as an organization described in IRC 501(c)(3) because, in spite of producing socially desirable results, the association furthered a substantial nonexempt purpose by serving the private interest of its owners/members other than incidentally.

Therefore, if more than an insubstantial percentage of the dwelling units in a given project (based on considerations of both available square footage and number of units) are occupied by persons who are not poor and distressed (lacking the basic necessities of life) then the organization is not qualified for exemption under IRC 501(c)(3). Nevertheless as previously discussed, some consideration should be accorded to the argument that providing a certain amount of housing to persons who are not poor and distressed indirectly furthers charitable purposes.

Although there is no clear guidance as to the actual percentage of units in a given project which must be made available to the poor (i.e. those unable to obtain the necessities of life without undue hardship), any test based on the percentage of units available for poor residents should be evaluated in light of all the facts and circumstances, including the bases for including persons who are not appropriate objects of charity.

Unrelated Business Income

Generally, the provision of low-income housing to persons who are other than poor and distressed or underprivileged does not serve a charitable purpose absent facts showing that the purpose of such housing is to combat community deterioration or relieve prejudice and discrimination. However, as previously discussed, having a mix that includes some residents who are not poor helps to

ensure long-term success of the project and, therefore, contributes importantly to achieving the exempt purpose. But, if the housing provided to persons who are not "poor" represents more than an insubstantial activity that is not treated as indirectly furthering charitable purposes, an organization does not qualify for exemption under IRC 501(c)(3) unless such housing is provided as part of an unrelated trade or business.

An organization may provide a significant amount of housing to persons who are not poor if the housing is provided as part of an unrelated trade or business activity and as long as the charitable purpose, such as assisting the poor, remains the organization's primary purpose. The concept that allows an organization to allocate a portion of the available units in a given low-income housing project to persons outside of a charitable class and not defeat exemption is premised on finding that the entire housing project furthers exempt purposes. However, where the organization's provision of housing to persons who are other than poor cannot be justified on the basis of indirectly furthering charity, there would be no basis for considering any portion of the housing provided to such persons as being in furtherance of charitable purposes.

Reg. 1.501(c)(3)-1(e) provides that where an organization operates a trade or business as a substantial part of its activities, all the circumstances must be considered to determine whether its primary purpose is to conduct exempt activities or to carry on an unrelated trade or business. In other words, where an organization provides at least in excess of 50 percent of its housing to persons who are poor and distressed or underprivileged, it may also provide housing to persons who are not poor provided this activity is conducted as an unrelated trade or business.

In this circumstance, the organization should be able to demonstrate that its program of providing housing to persons who are not poor and distressed or underprivileged is at fair market value and otherwise is operated as an ordinary trade or business for profit.

IRC 513(c) provides that an activity carried on for the production of income does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Thus, if an asset or facility necessary to the conduct of exempt functions is also used in a commercial endeavor (such as would be the case where housing is provided as part of an ordinary trade or business to persons who are not poor), the

fact that the asset or facility is used for exempt functions does not, in and of itself, make the income from the commercial endeavor gross income from a related trade or business. See Reg. 1.513-1(d)(4)(iii).

In Rev. Rul. 78-98, 1978-1 C.B. 167, an exempt school operates a ski facility for use in its physical education program and also for use, to a substantial degree, for recreational purposes by students attending the school and members of the general public who are required to pay slope and lift fees comparable to nearby commercial facilities. The ruling holds that the educational and recreational use of the facility by the students is substantially related to the school's exempt purposes and the income derived from the students' use of the facilities is not from unrelated trade or business under IRC 513. However, income from the use of the facility from the general public is from an unrelated trade or business.

Typically, housing organizations derive rental income from their provision of housing. Although rents from real property are generally excluded from the definition of unrelated business taxable income pursuant to IRC 512(b)(3), the exclusion does not apply where personal services are also rendered to the occupant (Reg. 1.512(b)-1(c)(5)) or where the property is debt-financed (IRC 512(b)(4)). Of course, rents attributable to the provision of housing for the poor would not be subject to unrelated business income tax in any event since it is substantially related to an organization's performance of its exempt purpose.

We would only subject that part of a low-income housing project that does not further charitable purposes to tax (provided that the organization satisfies the primary purpose test and truly operates the unrelated housing as a trade or business for profit) after finding that the provision of some housing to persons who are not poor and distressed or underprivileged does not indirectly further charitable purposes.

Changed Circumstances

After receiving recognition of exemption, a low-income housing organization must keep track of the composition of its housing project to determine whether the percentage of units occupied by the poor and distressed or the underprivileged has changed due to either vacancies or to rising income levels of occupants. When a vacancy occurs, a housing organization should realize that because of the changed circumstances of the building, the provision of a vacant unit to persons who are not poor could subject it to unrelated business income tax

or even loss of exemption. The fact that an organization may be unable to locate poor persons to occupy the vacant units is not a mitigating factor.

In addition to vacancies, the mere fact that the income levels of the occupants of a given housing project may have risen above the poverty level could subject a housing organization to unrelated business income tax or even loss of exemption. Unlike the above situation with vacancies, however, mitigating factors will be taken into consideration. In this circumstance, mitigating factors would include the inability of a person to afford housing even with a higher income level or a policy by the organization to continue to provide housing, for a reasonable time, to persons whose income levels have risen as an incentive to encourage them to better their financial circumstances without jeopardizing their housing.

6. Promotion of Social Welfare

In the preceding discussion, we stated that an organization formed to provide relief to the poor through the provision of low-income housing must make substantially all of its dwelling units available to those lacking the basic necessities of life. This requirement is intended to ensure that an organization providing low-income housing does not serve individuals who are not members of a charitable class other than incidentally. However, there are other ways in which a housing organization may qualify as exempt under IRC 501(c)(3).

In G.C.M. 36293, Chief Counsel stated that if the essential purpose of an organization is to engage in activities that promote social welfare by achieving any of the purposes specified in Reg. 1.501(c)(3)-1(d)(2), then it would qualify for exemption under IRC 501(c)(3) if the other requisites of exempt status are present, even though some or all of the individuals who benefit from the organization's activities may not be members of a traditional class of charitable recipients.

As previously noted, Reg. 1.501(c)(3)-1(d)(2) provides that the term "charitable" as used in IRC 501(c)(3) includes the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration.

Also as previously discussed, G.C.M. 36293 acknowledges that it has come to be general common knowledge that a limitation of the occupants of new subsidized housing developments to low-income families is likely to preclude such projects from providing any very satisfactory long-term alleviation of community deterioration commonly associated with deficient and overcrowded housing under

congested city conditions. The memorandum also states that, for this reason, there can be no doubt that the provision of housing assistance to both low and moderate-income residents in a generally deteriorated metropolitan area as a means of helping them obtain substantially better living conditions without having to move to a different area of the same city deserves to be classified as action that is reasonably well suited to combatting community deterioration.

According to G.C.M. 36293, the reason the Corporation was ruled to be not exempt was its failure to make a reasonably adequate demonstration that its projected activities could be possibly classified as the promotion of social welfare by lessening neighborhood tensions, eliminating prejudice and discrimination, or combatting community deterioration within the meaning of Reg. 1.501(c)(3)-1(d)(2).

For organizations claiming to relieve neighborhood tensions and/or eliminate prejudice and discrimination as their exempt purposes, G.C.M. 36293 offers the following guidance:

"The clear implication of [Reg. 1.501(c)(3)-1(d)(2)] is that the neighborhood tensions with which a charitable organization can reasonably expect to deal in a significant manner by housing activities is limited to tensions in the same general neighborhood where such housing activities are to be carried on. By virtue of the fact that neighborhood tensions are a common result of prejudice and discrimination, we believe a similar approach should likewise be used with respect to the conduct of any comparable activities that are allegedly designed or intended to eliminate prejudice and discrimination of the general character contemplated by this Regulation."

Concerning combatting community deterioration, G.C.M. 36293 reasons as follows:

"In the case of efforts to combat community deterioration, however, there appears to be room for a somewhat more liberal approach, subject to the observance of appropriate safeguards. In other words, we think it would be possible to combat either actual or potential community deterioration that centers in some specifically identifiable inner city sections of a large metropolitan area by increasing the available supply of adequate housing in another nearby section of the same general community if that increase is so located and offered for sale or rental on a preferential basis as to have some reasonably good prospect of making a significant contribution to the alleviation or avoidance of an existing or threatened deterioration of such inner city sections.

"If the moderate income families in a given locality are having difficulty in finding decent, safe, and sanitary dwellings at rents or purchase prices they can afford, we can reasonably assume that low-income families who need to locate there would often have to settle for something substantially less. The plight of these poor families would clearly contribute to community deterioration by fostering overcrowded housing conditions and all the various adverse social consequences commonly associated with such conditions. Any systematic and reasonably effective program that is carried on for the sole purpose of helping the low-income victims of such a situation move into better living quarters, and thereby reducing or eliminating municipal squalor, would thus appear to come within the clear intendment of that portion of [Reg. 1.501(c)(3)-1(d)(2)] which refers to combatting community deterioration and juvenile delinquency."

Note that G.C.M. 36293 does not require that the community be in an actual state of deterioration since an organization designed to combat potential community deterioration may qualify for exemption under IRC 501(c)(3).

In sum, If an organization claims that its activities are designed to eliminate prejudice and discrimination, it is up to the organization to show that the present racial and ethnic mix has given rise or is likely to give rise to neighborhood tensions of some substantial consequence and that the organization's program is designed to alleviate such problems by providing solutions through housing programs located in that neighborhood experiencing neighborhood tensions or prejudice and discrimination. Similarly, organizations combatting community deterioration should locate their programs within the suffering community or, in special circumstances, in a nearby section of the same general community.

If an organization claims that it is combatting community deterioration, the organization must substantiate its claim with sufficient facts, e.g. a designation by the local, state or federal government that the area to be served is blighted, or designated for community redevelopment, or threatened by blight or community deterioration. If an organization submits evidence that a particular area has been designated by a governmental authority as blighted or threatened by blight, the specialist or agent should inquire into the nature of the agency or person that made the determination of blight. For instance, a letter from a mayor or a chairman of a state or local government endorsing a particular applicant's program should be given close scrutiny as to the basis on which such determination was made. The determination of blight should come from a federal, state, or local municipal agency which has some authority in making such determinations. It may also be advantageous to get a description of exactly how the state or local agency defines blighted. After all, to some state agencies blighted may mean simply

"undeveloped." Once requested, the burden should be on the housing organization to provide sufficient information in this regard.

In the case of the organization discussed in GCM 36293, it was unable to demonstrate that providing housing for mostly middle income persons in an area removed from any areas undergoing deterioration furthered any exempt purposes.

We must also remember that even if an applicant can produce sufficient evidence that the area to be served by its activity is blighted, this fact is not cause for immediate exemption or continued qualification. If an organization's activities evidence private interests being served, it is still up to the specialist or agent to determine whether the private benefit is sufficient to disqualify it for exemption. An organization that serves private interest other than incidentally is not entitled to exemption under IRC 501(c)(3). See generally the discussions on private benefit beginning on page 16 of the Exempt Organizations Continuing Professional Education Technical Instruction Program for 1990.

7. Other Considerations

What requirements, if any, should be imposed on an organization providing low-income housing to assure that the housing will remain dedicated to charitable purposes?

Once an organization demonstrates that it is organized and operated exclusively for exempt purposes through the provision of low-income housing, the question arises as to what requirements should be imposed to ensure continuation of the "low-income" nature of the housing project. The concern is that there may be factors that could influence the "low-income" character of the project such as an upswing in the economic viability of the area so that the project could command greater profits through a change in resident composition. Although IRC 42 provides requisite periods of time for which a project must remain low-income housing (fifteen years), this time period has no relationship to furthering charitable purposes. If there is a possibility in a particular case that the property will revert to a private owner in the future, or serve some other private interest, or lose its "charitable" nature, the specialist or agent should develop the case by pointing out these potential problems. Organizations are usually very agreeable to include provisions in the rental agreements or deeds of sale which provide adequate safeguards against the transformation of the low-income property without adequate safeguards to protect the interests of the low-income occupants. Contractual safeguards could be requested in the form of a restrictive covenant guaranteeing

use of the project for charitable purposes for a period of time or granting a charitable organization the right of first refusal should the nature of the project be altered.

8. The Future

Congress enacted Public Law 101-73, 103 Stat. 363 (Aug. 9, 1989) setting the parameters for the Resolution Trust Corporation (RTC), a federal agency established to manage and resolve failed savings associations that were insured by the Federal Savings and Loan Insurance Corporation, to follow in the disposal of its property holdings. Within the legislative effort, Congress charged the RTC with maximizing the availability and affordability of residential real property for low and moderate income individuals.

Future problems may arise because the RTC, which has taken over the assets of failed savings and loan organizations, designates certain qualifying organizations as "multifamily purchasers." This designation by the RTC entitles multifamily purchasers to acquire buildings dedicated to providing housing for low-income residents at extremely favorable terms. Undoubtedly, the more sophisticated of these entities will apply for exemption under IRC 501(c)(3) on the basis that their activities either relieve the poor and distressed or lessen the burdens of government. However, RTC's lower-income occupancy requirements differ materially from our requirements for organizations providing low-income housing. For example, in order to qualify as a multifamily purchaser under the RTC regulations, not less than 35 percent of all dwelling units purchased by a qualifying multifamily purchaser shall be made available for occupancy by and maintained as affordable for lower-income families (80% of median income) during the remaining useful life of the property in which the units are located, provided that not less than 20 percent of all units shall be made available for occupancy by and maintained as affordable for very low-income families (50% of median income) during the remaining useful life of such property. As discussed earlier in this article, such percentages would fall woefully short of the percentages required for organizations seeking exemption under IRC 501(c)(3) on the basis of relieving the poor. Since multifamily purchasers would not qualify for exemption on the basis of relieving the poor, the next logical basis would be lessening the burdens of government.

Exemption based on lessening of governmental burdens is a facts and circumstances determination. Rev. Ruls. 85-1 and 85-2, 1985-1 C.B. 177, set forth the following criteria for determining whether an organization's activities are

lessening the burdens of government: whether the governmental unit considers the organization's activities to be its burden, and whether these activities actually lessen the burden of the governmental unit. For a further discussion of the application of these criteria, see G.C.M. 39685, (December 10, 1987), and G.C.M. 39733, (May 24, 1988). Therefore, each organization representing that it is exempt based on lessening of government burdens will have to be considered on its own merits.

9. Conclusion

The determination as to whether a particular housing project is "charitable" within the meaning of IRC 501(c)(3) is primarily a facts and circumstances test. If an organization claims that it is organized and operated to relieve the "poor and distressed" by providing low-income housing, and does not claim that it is promoting "social welfare" within the meaning of Reg. 1.501(c)(3)-1(d)(2), the specialist or agent should determine that the recipients of the organization's activities are "needy" in the sense of being unable to obtain the necessities of life without undue hardship. The fact that a particular housing project is considered "low-income" by HUD, or any other federal or state governmental agency, is not determinative in the determination of whether or not the provision of such housing furthers a recognized charitable purpose.

If an organization claims that it is promoting social welfare within the meaning of Reg. 1.501(c)(3)-1(d)(2), it must submit sufficient evidence to establish that in fact the conditions which it seeks to alleviate (prejudice, discrimination, community deterioration) do exist and that its activities are likely to alleviate such problems.